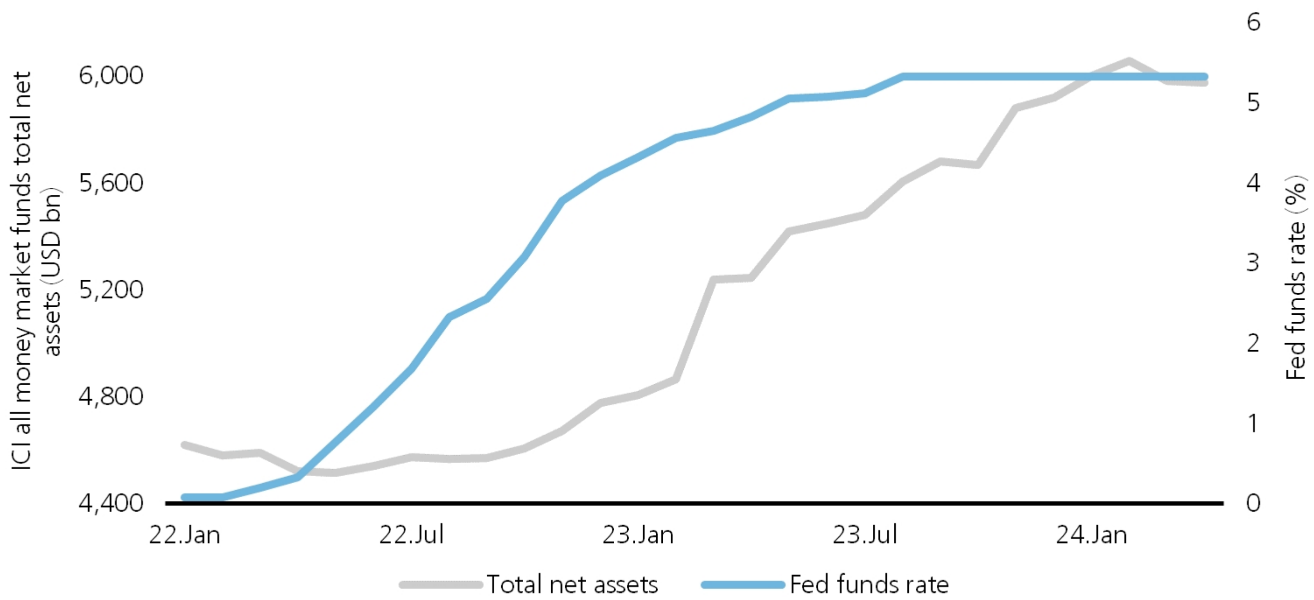

Cash piles have grown with higher rates. (UBS)

Time to put cash to work

30 April 2024, 10:30 pm CEST, written by UBS Editorial Team

Investors added billions into money-market funds, but it is time to put cash to work.

Is it time to reduce cash holdings? Yes.
We recommend investors manage liquidity. While interest rates look likely to stay higher for longer in the US, it will not be forever. Rate cuts are likely in 2024, and this will lead to progressively lower returns for cash over the coming two years. As a result, we recommend investors build a liquidity strategy beyond cash and money market funds through a combination of fixed term deposits, bond ladders, and structured investment strategies to cover expected portfolio withdrawals over the next five years.

With rate cuts still on the horizon in 2024, investors face potential loss of income. Market expectations have gone from implying as many as six 25bps cuts at a peak in January to less than two at present. But we believe the current level of US interest rates is high enough to push growth below trend and inflation lower, and interest rates on cash are poised to fall in 2024.

When the Fed starts to cut rates, falling yields will favor bonds over cash. We recommend investors lock in attractive yields on quality bonds.

Investors will face reinvestment and duration risks.

- Reinvestment risk: the chance that cash flows received from an investment will earn less when put to use in a new investment. When yields fall, cash will experience more reinvestment risk than bonds, because their return comes from income. By contrast, bonds have a higher duration risk than cash, so they will experience price appreciation due to falling yields.
- Duration risk: the risk that a change in interest rates will either increase or decrease the market value of a fixed income investment. In past market cycles, high-quality bonds have experienced a much larger benefit from falling yields than

cash due to their higher duration risk, even though short-term bond yields tend to fall more than longer-term yields and credit spreads tend to widen (which dampens high-quality bonds' tailwind from falling Treasury yields).

We believe this is a good time to lock in higher yields. We recommend investors lock in currently high yields since our base case remains that the Fed will begin to cut rates in September, with 50 basis points of total easing by the end of this year.

We recommend a well-diversified liquidity strategy for investors who wish to manage liquidity:

- Fixed-term deposits. Since we expect interest rates to fall in 2024, we believe investors who are interested in covering potential expenses and liabilities up to 12 months out should use fixed-term deposits to lock in currently high yields on cash. Investing in fixed-term deposits of different maturities can also help match liabilities and reduce interest rate and reinvestment risks.
- Bond ladders. We recommend investors lock in currently attractive bond yields. For expected portfolio withdrawals over the next 12-60 months, bond ladders involve buying a series of individual short-duration bonds of varying maturities, staggered to provide a steady stream of income and aligned with the size and timing of expected portfolio withdrawals.
- Structured strategies with capital preservation features. These strategies are recommended for investors who intend to use cash in three to five years' time, but wish to participate in further equity gains while also limiting losses. The currently low equity market volatility improves the pricing of such strategies. Since costs may apply if investors need to sell before maturity, we suggest using these tools to cover longer-term liabilities.

Did you know ?

- A 60/40 portfolio of US large-cap securities and bonds beat cash around 80% of the time over a five-year period, based on data going back to 1926.
- Historically, cash only outperformed bonds early in the hiking cycle—as we saw in 2022—with global bonds starting to outperform even before rates peaked.
- There are record net assets in money market funds. According to the Investment Company Institute (ICI), total money market net flows climbed to nearly USD 6.0 trillion by the end of April 2024 after the Federal Reserve hiked rates and yields rose on cash accounts. Nearly USD 1.1 trillion were added by investors to US money market funds in 2023, with an additional USD 58 billion of net inflows since the start of 2024.

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